DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 01-0025
SALES AND USE TAX
For the Tax Years 1997, 1998, and 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Applicability of the State's Gross Retail Tax to Taxpayer's Rental of Customized Mailings Lists.

Authority: IC 6-2.5-3-2; 45 IAC 2.2-4-2; Sales Tax Information Bulletin #8.

Taxpayer protests the imposition of use tax on its rental of customized mailing lists arguing that taxpayer is contracting for a service and not renting tangible personal property.

II. Prospective Treatment of Gross Retail Tax Liability.

Authority. City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998); IC 6-8.1-3-3.

Taxpayer argues that, upon a determination that it is responsible for paying use tax on the rental of mailing lists, it is entitled to prospective treatment of that liability.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority. IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer argues that because the applicability of the gross retail tax to the purchase of customized mailing lists is a "gray" area of the law, the Department of Revenue (Department) should exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of conducting industrial training seminars. In order to attract customers for those seminars, taxpayer sends out periodic mailings targeted to those persons and business entities which would be likely customers. To assure that the mailings are appropriately directed, taxpayer deals with a direct mail list broker. Taxpayer provides the list broker with various criteria in order to allow the broker to prepare an appropriate mailing list. Taxpayer provides criteria including – but not limited to – business type, number of employees, sales volume, location, warehouse square footage, internet access, title, and buying authority.

Once the list broker receives the criteria, it conducts an electronic search of its database. The broker prepares the mailing list – based upon the taxpayer's specifications – and reduces the list to magnetic tape. The list broker then transfers the magnetic tape to an independent mailing house which prepares and arranges for the delivery of the mailing. Under its agreement with the list broker, taxpayer is entitled to use the mailing list once. According to taxpayer, it never acquires possession of the rented magnetic tape and is never aware of the contents of the magnetic tape.

The issue raised by the taxpayer is whether the rental of the mailing list is subject to the state's gross retail tax. The audit determined that the transaction was essentially one for the sale of information and that the sale was subject to use tax. Taxpayer disagrees with this characterization and argues that when the list broker rents the mailing list to the taxpayer, the list broker is renting information supplied by the taxpayer itself.

DISCUSSION

I. Applicability of the State's Gross Retail Tax to Taxpayer's Rental of Customized Mailings Lists.

Taxpayer protests the assessment use tax on the rental of mailing lists. Under IC 6-2.5-3-2, "[a]n excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2(a).

45 IAC 2.2-4-2 distinguishes the purchase of tangible personal property from the purchase of services which are not subject to the tax. The regulation states that "[p]rofessional services, personal services, and services in respect to property not owned by the person rendering such services are not 'transactions of a retail merchant constituting selling at retail', and are not subject to gross retail tax."

Taxpayer believes that when it rented the mailing lists, it was simply acquiring the services of the list broker delivered in the form of a tax-exempt computer program. The audit believes that the rental of the mailing lists was the rental of tangible personal property and was properly subject to the gross retail tax.

Sales Tax Information Bulletin #8 states that the purchase of certain computer software is not subject to the state's gross retail tax. The Bulletin states that "transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser." Sales Tax Information Bulletin #8, II, B. Taxpayer believes that the purchase of the mailing lists, encoded on magnetic tape, falls within this provision.

However, the Bulletin also states that other computer software is subject to the tax.

> Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook. Id.

However, even more relevant to the issues raised by taxpayer is provision in the same bulletin which states that;

> the sale of statistical reports, graphs, diagrams or any other information produced or compiled by a computer and sold or reproduced in substantially the same form as it is so produced is considered to be the sale of tangible personal property . . . . Id. at II, F.

Taxpayer argues that the rental of the mailing lists is analogous to a computer programmer writing a specific program for one of the programmer's customers. According to taxpayer, because the specifications it provides to the list broker are of such complexity and specificity, the list broker is acting as a designer of specialized computer software and is crafting a "one-time" computer program. However, taxpayer's characterization of the mailing list rentals assigns those transactions a level of complexity which is unnecessary for understanding the nature or tax consequences of the transactions. The list broker owns a "bank" of addresses which have been carefully categorized. Taxpayer approaches the list broker with a set of explicit requirements and, in effect, tells the list broker which of those addresses it wishes to acquire. The list broker then assembles those addresses, transfers that information into the form of magnetic tape, and makes the addresses – albeit indirectly – available for the taxpayer's one-time use. Certainly a great deal of effort goes into establishing the parameters of that mailing list, but that creative effort is the taxpayer's and not the list brokers. The actual transaction between taxpayer and the list broker is straightforward; the list broker owns a substantial amount of information and taxpayer contracts to acquire some of that information delivered in the form of magnetic tape.

As described in Sales Tax Information Bulletin #8, II, F, a transaction involving the sale of information compiled by a computer is considered to be the sale of tangible personal property. Under IC 6-2.5-3-2, the use tax was properly assessed on transactions involving the rental of tangible personal property in the form of magnetic tapes containing mailing lists.

FINDING

Taxpayer's protest is respectfully denied.

II. Prospective Treatment of Sales Tax Liability.

Taxpayer argues that the Department – having found that the rental of mailing lists is subject to use tax – should impose that tax liability on a prospective basis only. Taxpayer believes that it would be inequitable for the Department to apply the use tax, penalties, and interest retroactively because it was never placed on notice that the transactions were subject to tax. Because it did not include the tax as part of its cost of doing business, assessment of the tax, penalties, and interest would subject the taxpayer to financial hardship.

Under IC 6-8.1-3-3, the Department is without authority to reinterpret a taxpayer's tax liability without promulgating and publishing a regulation giving taxpayer notice of that reinterpretation. IC 6-8.1-3-3(b) states that "[n]o change in the department's interpretation of a listed tax may take effect before the date the change is: (1) adopted in a rule under this section; or (2) published in the Indiana Register . . . ."

In City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998), plaintiff taxpayer argued that the Department could not impose gross income tax on the gain realized from the sale of tax exempt bonds, because that gain had been treated as exempt for 42 years. Id. at 1128. Plaintiff taxpayer argued that, in the absence of a new rule or regulation, the Department's assessment of gross income taxes against the gain realized from the sale of bonds was invalid. Id. at 1129. The Tax Court found that, despite the intervening adoption of regulations to the contrary, the Department could not impose the additional taxes when the Department had permitted plaintiff taxpayer to claim an exemption from the taxes subsequent to the adoption of the intervening regulations. Id. However, the Tax Court also held that plaintiff taxpayer, having been placed on notice of its additional tax liability, was responsible for paying the tax on a prospective basis. Id.

Taxpayer believes that it is in the same situation as plaintiff taxpayer in City Securities and, as a consequence, is entitled to the same prospective treatment of its own tax liability. In support of its position, taxpayer cites to three documents previously issued by the Department – a published Revenue Ruling, a published Letters of Findings, and an unpublished Letter of Findings – which purportedly placed taxpayer in the "perplexing position of uncertainty as to the taxability of these transactions." However, setting aside questions regarding taxpayer's interpretation and application of those documents, taxpayer has failed to demonstrate that it any way relied upon those documents when it initially reached a decision that the mailing list transactions were not subject to the gross retail tax. Unlike the plaintiff taxpayer in City Securities, which for five years relied on the Department's specific determination that the gross income tax was inapplicable to gain realized from the sale of the tax-exempt bonds, taxpayer has provided no information indicating that it relied upon a regulation, ruling, interpretation, in determining its liabilities under the state's gross retail tax scheme. Rather, the statutes, regulations, and

information bulletin setting forth that liability were fully in place at the time the mailing list transactions occurred.

Absent any information that the Department has altered its interpretation of the taxpayer's gross retail tax liabilities subsequent to the time taxpayer incurred those liabilities, taxpayer is not entitled to prospective treatment of that liability pursuant to IC 6-8.1-3-3.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten Percent Negligence Penalty.

Taxpayer has requested that the ten-percent negligence penalty, imposed under authority of IC 6-8.1-10-2.1(a), be abated with respect to the additional gross retail taxes assessed against transactions involving the rental of mailing lists. Taxpayer argues that imposition of the tax, interest, and the ten-percent penalty is inequitable because taxpayer was never placed on notice that the mailing list transactions would ever be subject to tax.

IC 6-8.1-10-2.1(d) states that if a person, subject to the negligence penalty, imposed under IC 6-8.1-10-2.1(a) can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the Department, was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2(b) defines "negligence" as the failure to use reasonable care, caution or diligence as would be expected of an ordinary, reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations. Id.

In order to waive the negligence penalty, the taxpayer must prove that its failure to pay the full amount of its tax liability was due to "reasonable cause." 45 IAC 15-11-2(c). Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." In determining whether reasonable cause exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

Taxpayer's general equitable arguments notwithstanding, taxpayer has provided the Department no basis upon which to determine that its failure to pay or even consider its potential gross retail tax liabilities was due to "reasonable cause." Taxpayer is a substantial and sophisticated business entity fully capable of carefully considering its various state tax liabilities. Absent any substantive, statutory, or factual basis upon which to predicate such a determination, the Department must decline taxpayer's request to abate the ten-percent negligence penalty.

FINDING

Taxpayer's protest is respectfully denied.